

**A Response to
Hong Kong Liner Shipping Association
“Supplementary Submission to Hong Kong Competition Commission, BE/0004”**

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The maritime transport industry has been one of the last major economic sectors that certain jurisdictions still have not fully applied their respective competition law¹. Major arguments are that the maritime sector differs significantly from all other economic sectors and because of its unique nature (high entry and variable cost and substantive investment requirement) and national importance, should not be subject to regulations of the traditional competition rules. In principle, block exemption from the competition authority would be granted when regulators believe that such arrangement generates more positive than negative effects to the economy and that benefits will be passed on the end consumers. The burden of proof is vested with the applicant.

**(1) Does Liner Shipping Require Different Treatment/Protection
under Competition Law—The Answer is No**

However, according to the European Union (EU) experience, in contrast to their consortium agreements (similar to “Vessel Sharing Agreements” of Hong Kong), the EU has concluded that there is a strong case against exemption of any liners’ cartel-related behaviours from the competition rules (Ilzkovitz, 2010). The major reasons are:

(i) The liner industry is not unique from other fixed-schedule and high-fixed-costs transport industries (or even the banking or telecommunication sectors as we see it). It can perform well under governance of the competition law. Empirical observations show that the carriers still serve non-exempted routes, such as

¹ Motor vehicle and insurance sector are also granted some exemptions from the European Union competition law.

the Asia-Europe trade, at a profit.

- (ii) The EU has not seen any evidence from the carriers to suggest the contention that liner cartels are necessary to provide reliable, efficient and reasonably priced services.
- (iii) There is however ample evidence that conferences and discussion agreements lead to higher rates to the detriment of shippers and consumers. Liner cartels clearly lead to a wealth transfer from customers to liner operators.
- (iv) Removing liners' block exemption in EU competition law has not lead to consolidation and oligopoly of the shipping industry. In any event, EU considers that consolidation (subject to merger rules) is preferable to cartels.

Summing up, EU concluded that the ideal antitrust regime in the liner shipping sector was to enact a limited exemption from the antitrust rules for consortia (similar to "Vessel Sharing Agreements" of Hong Kong), while applying the full force of the competition rules to liner cartels. Cartels in any other sector are prohibited. EU has found no evidence to support treating the liner sector differently (Ilzkovitz, 2010).

(2) Are economic efficiency arguments provided by HKLSA to support "Revised VDA Scope" convincing—The Answer is No

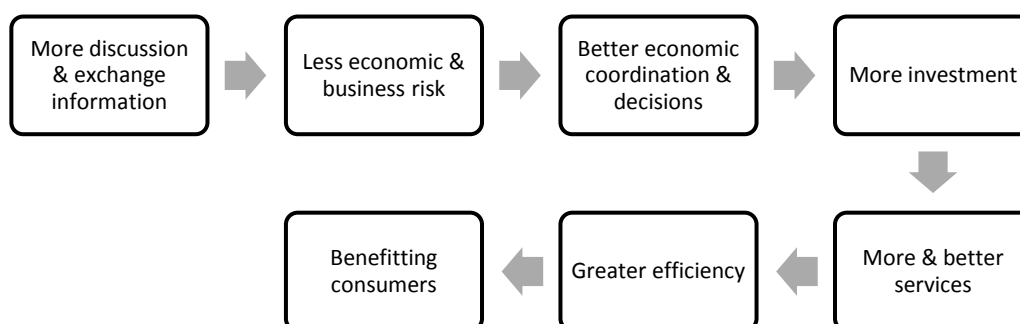
According to paragraph 3.4 of the Supplementary Submission (SS), the Hong Kong Liner Shipping Association (HKLSA) recognized that the Commission's Guideline to the First Conduct Rule (FCR) covered certain benefits arising from information exchange. Competition is often enhanced through the sharing of information, for example, in relation to best practices or exchanges of information which allow firms to better predict how demand is likely to evolve. But this Guideline also discussed the potential competition concerns from the exchange of information which related to "customers, production, costs, quantities, turnover, sales, capacity, product quality, marketing plans, risks, investments, technologies and innovations"(Hong Kong Liner Shipping Association, 2017). We agree that the latter subjects are generally regarded as confidential information, if being exchanged or even agreed upon, would directly or indirectly lead to effects of cartel-like behaviour that will harm competition.

However, according to paragraph 3.3, the HKLSA stated that the Commission's Guideline to FCR did not sufficiently provide carriers with the clarity needed to ensure compliance with the Ordinance. Thus, HKLSA is seeking Block Exemption for the "Revised VDA Scope"(excluding any Hong Kong-specific pricing discussions and

voluntary agreements only) which would be specifically authorised for (i) discussion, (ii) information exchange and (iii) reaching voluntary agreements on the following items (paragraph 2.3 of the SS):

- (i) Supply and demand trends;
- (ii) General industry issues, general economic issues and trends, and revenue/rate indices based on aggregated historical data;
- (iii) Regulatory development and compliance issues;
- (iv) Carrier cost (general and Hong Kong-specific);
- (v) Vessel utilization and capacity levels; and
- (vi) Best practices (general and Hong Kong specific), including service contract rules, terms and conditions.

The SS document provided some economic arguments to support the “Revised VDA Scope” to apply for block exemption (in Section 4). The “economic” logic is generally running like the following:



However, no economic benefits have been directly accounted for in the document quantitatively, not to mention about lacking any assessment regarding “a fair share of the benefit with consumers”. The document did not cite even one relevant economic analytical report to validate HKLSA’s arguments. The “economic” logic promulgated, if accepted, would stimulate every economic sector in Hong Kong to formulate similar agreements seeking block exemptions for possible colluding activities.

(3) Would the “Revised VDA Scope” Restrain Liners from Cartel Behaviour—The Answer is No

With all these cost, capacity utilization and contract information being discussed, exchange and agreed upon in Hong Kong (i.e. items (iv), (v) and (vi) in Section 2), we strongly believe that the members of the HKLSA could coordinate prices (and other

terms and conditions of service contracts), both explicitly or tacitly, even without an agreement on setting prices.

Indeed, immediately after repealing of the liner Conference block exemption from EU Competition Law in 2009, liner shipping companies started to undertake price signaling to coordinate price hikes. On 21 November 2013, the European Commission formally initiated an antitrust proceeding against 14 liner shipping companies to investigate whether they had engaged in concerted practices against EU antitrust rules (European Union, 2015). These carriers have been making regular public announcements of price increase intention (known as General Rate Increases or GRIs) through press releases on their websites. Since 2009, more than 55 GRI rounds took place. They included the amount of the increase and the date of implementation, which are generally similar for all announcement carriers.

The announcements are usually made by the carriers successively a few weeks before the announced implementation date. According to the industry press the carriers typically announced increases of 40 to 80% to the prevailing market price, but it is not unusual for announced increases to reach 120 to 180%. The perception in the industry is that GRIs are often announced against market conditions when demand is low and supply is high (European Union, 2015). The Commission has concerns that this practice may allow the carriers to signal future price intentions to each other and may harm customers by raising prices for liner shipping transport services on routes to and from Europe.

We consider that the prevalent Guidelines of the FCR for “Information Exchange” would be sufficiently enough to provide a legally transparent and workable environment for the operation of the shipping industry, as well as to any other industry, in Hong Kong. There should be no need to grant Block Exemption to any types of VDA for the liner shipping industry.

(4) Would the Repealing of VDA Destabilize the Liner Shipping Industry in Hong Kong—The Answer is No

This is an empirical question of a future event and we cannot provide a direct answer at this point of time. HKLSA might wish to project the impression that VDAs are essential for the healthy operation and stability of the liner shipping in Hong Kong, and thus to the greater benefits of Hong Kong consumers and the economy. Here we would

like to present the empirical findings of an elaborated study undertaken by the Federal Maritime Commission (FMC) of the US Government in 2012 for reference (Federal Maritime Commission, 2012). The objective of the Study was to assess what impact the EU repeal might be having on shipping in the US and EU liner trade, and the three major findings were the following.

- (i) The repeal of the block exemption does not appear to have resulted in any negative impact on US liner trades.
- (ii) While the activities of carrier rate discussion agreements in US trades do not appear to have increased average rate relative to rates in EU trades, they may have contributed to the reduction of rate volatility modestly².
- (iii) The repeal of the block exemption may have resulted in a modest increase in market concentration. However, given the lack of concentration in the liner trades studied, such an increase is unlikely to present problems.

The first conclusion of this Study would reciprocally imply that the repeal of block exemption in EU shipping has not resulted in any negative impact on EU liner trades. Furthermore, in view of the existence of some constrained rate discussion agreements in the US, EU's shipping industry has not been in a disadvantage position in terms of rates after the repealing of block exemption. The EU repeal did not result in any destabilizing effects on the US and EU liner trade. Although the structure of Hong Kong liner shipping may not be the same as the US and EU liner shipping (but operating by the same major carriers), we do not observe any evidence supporting that rejecting all VDAs for block exemption would lead to instability in Hong Kong's liner shipping industry.

(5) Conclusion

We strongly support Competition Commission's initial decision to reject the granting of block exemption to any VDAs. We would like to reiterate the following supporting arguments:

² According to Federal Maritime Commission (2012), "In US trade today, the Shipping Act of 1984 allows liner companies to establish various sorts of multi-member liner agreements that have limited antitrust immunity, including some that authorize members lines to discuss and voluntarily agree on pricing matters. Antitrust immunity under the Shipping Act is, however, constrained by a variety of explicitly prohibited acts and restrictions on "unreasonable practices." Carrier agreements are also subject to ongoing monitoring and enforcement actions by the FMC."

- (i) With the Ocean Shipping Reform Act of 1998 in the US and repealing of the liner conference block exemption from EU Competition Law in 2009, this is the right time for Hong Kong to adopt the best international practices. Indeed, all the international liner shipping companies registered in Hong Kong have been operating in these HK/Europe and HK/America routes for many years and they are very familiar with the legal and operating environment of the European and US markets.
- (ii) Other than providing some economic arguments to support the “Revised VDA Scope”, no economic benefits have been directly accounted for by the HKLSA quantitatively, not to mention about lacking any assessment regarding “a fair share of the benefit with consumers”. The burden of proof should be vested with the applicant. The “economic” logics promulgated, if accepted, would stimulate every economic sector in Hong Kong to formulate similar agreements seeking block exemptions for possible colluding activities.
- (iii) The EU clearly concluded that there was however ample evidence that conferences and discussions agreements lead to higher rates to the detriment of shippers and consumers. Liner cartels clearly led to a wealth transfer from customers to liner operators.
- (iv) The FMC Study stated that the repeal of the block exemption in EU in 2009 had not resulted in any negative impact on US liner trade. The EU repeal did not result in any destabilizing effects on the US and EU liner trade as well. Although the structure of Hong Kong liner shipping may not be the same as the US and EU shipping industry, we do not observe any evidence supporting that rejecting all VDAs for block exemption would lead to instability in Hong Kong’s liner shipping industry.

In conclusion, block exemption may be granted to a sector only when net benefits to consumers out-weight negative effects and a fair share of the benefits with consumers. These net benefits and their fair share with consumers need to be quantitatively assessed by the applicant for block exemption. Legal oversight should be put in place to ensure legal compliance, prevent abusive market domination and to promote a competition business environment to enhance market efficiency within the shipping industry in Hong Kong.

References

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- (3) Hong Kong Liner Shipping Association. (2017). *Supplementary Submission to Hong Kong Competition Commission, Case Number BE/0004*.
- (4) Ilzkovitz, F. (2010, October 1). HT.641 - CCS's proposed recommendations with respect to the Competition (Block Exemption for Liner Shipping Agreements) Order 2006.
- (5) United Nations Economics and Social Commission for Asia and the Pacific. (2015). *Shipping Block Exemption from Competition Law* (Policy Brief).